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IN THE

Supreme Court of the United States

October Term, 1970

No. 1493

VERNITRON CORPORATION and AMERICAN MEDICAL INSTRUMENT CORPORATION,

Petitioners,

against

PAUL BENJAMIN,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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IN THE

Supreme Court of the United States

October Term, 1970

No.

VERNITRON CORPORATION and AMERICAN MEDICAL INSTRUMENT CORPORATION,

Petitioners,

against

PAUL BENJAMIN,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit entered herein on March 5, 1971.

Opinions Below

The opinion of the Court of Appeals, as yet unreported, appears in the Appendix, *infra*, pp. 1a-6a. The opinion of the District Court is reported at 317 F. Supp. 185 and appears in the Appendix, *infra*, pp. 7a-17a.

Jurisdiction

The judgment of the Court of Appeals for the Second Circuit was entered on March 5, 1971. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

Questions Presented

1. Whether 28 U.S.C. § 2283 operates as a bar to the issuance of an injunction where it is necessary in aid of the District Court's jurisdiction by reason of the collateral estoppel and *res judicata* effects of a state court judgment?

2. Whether an injunction under 28 U.S.C. § 2283 may issue pursuant to 15 U.S.C. § 78u(e), § 21(e) of the Securities Exchange Act of 1934, when a litigant in a state court action is attempting to violate the provisions of Sections 10(b) and 29(b) of the Securities Exchange Act of 1934?

Statutes and Regulation

The pertinent provisions of 15 U.S.C. §§ 78j(b), 78u(e) and 78cc(b); of 28 U.S.C. §§ 1738 and 2283; and of 17 C.F.R. § 240.10b-5 are printed in the Appendix, *infra*, pp. 18a-20a.

Statement of the Case

On June 16, 1970, petitioners sued in the United States District Court for the Southern District of New York under Section 27 of the Securities Exchange Act of 1934 ("Act") (15 U.S.C. § 78aa) and asserted claims against respondent as follows: (1) a claim arising under Sections 10(b) and 29(b) of the Act (15 U.S.C. §§ 78j(b) and 78cc(b)) seeking damages and rescission for respondent's breach of a written assets acquisition agreement ("Agreement") entered into between petitioner Vernitron Corporation ("Vernitron"), respondent and two others; (2) pendent claims for breach of contract and common law fraud arising out of respondent's breaches of warranties, misrepresentations, nondisclosures and omissions in connection with the Agreement; and (3) a claim under 28 U.S.C. § 2283 to

enjoin the continued prosecution of a related state action (1-14).*

On December 20, 1967, respondent and his former company, American Medical Instrument Corporation, entered into the Agreement with petitioner Vernitron and a wholly-owned subsidiary of the New York corporate predecessor of Vernitron. The wholly-owned subsidiary, which then changed its name to American Medical Instrument Corporation, is now the other petitioner in this action.

Under the Agreement, Vernitron purchased the assets, properties, business and good will of respondent's company for Vernitron's common stock of the value of $1,500,000, a certificate representing 27,778 shares of Vernitron common stock being delivered at the closing to an escrow agent (43-92).

Under the Agreement, respondent was entitled to make demand upon Vernitron to cause to be registered certain shares of Vernitron's common stock being held in escrow. Pursuant to respondent's demand, Vernitron caused to be registered in June, 1968 approximately $250,000 of its securities, which it released from escrow and sold on respondent's behalf.

In June, 1968, after respondent was confronted by Vernitron with the fact that many more of the contracts of respondent's company were subject to the rules and regulations of the Small Business Administration than had been so warranted by respondent in the Agreement, the purchase price was reduced by $200,000 to $1,300,000 (101-102).

Subsequently, on February 1, 1969, respondent made demand upon Vernitron to register the balance of his shares which were being held in escrow. Since Vernitron

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* Unless otherwise designated, all references are to page numbers of respondent's Appendix filed with the Second Circuit Court of Appeals.

discovered that respondent had made certain other material misrepresentations, nondisclosures and omissions in connection with the negotiation and consummation of the Agreement, it refused to register the balance of the shares held in escrow.

On November 6, 1969, respondent brought his action against petitioners and another in the Supreme Court of the State of New York, County of New York, alleging four causes of action arising out of their alleged breach of the Agreement ("state action"). Petitioners counterclaimed in the state action for damages and rescission based upon breaches by respondent of eight specific warranties and representations contained in the Agreement. Petitioners claimed in the state action that the full measure of their damages was not determinable; that the earnings of respondent's company had been substantially overstated; and that as a result of the cumulative effect of all the misrepresentations, petitioners were entitled to rescind the transaction (105-114, 122-131). Since petitioners alleged that they had purchased respondent's company as an ongoing business on the basis of paying a multiple of earnings, they asserted that any misrepresentations, as set forth in their state court counterclaims, which affected such earnings, had a multiplied effect upon the damages to petitioners.

On June 2, 1970, respondent made a motion in the state action for summary judgment in the sum of $1,051,085.63, the amount allegedly owed by petitioners to respondent under the Agreement. This motion was argued on June 19, 1970, as was petitioners' cross-motion in state court to stay the continued prosecution of the state action pending the determination, in the federal action, of petitioners' federally exclusive §§ 10(b) and 29(b) claims.

Contemporaneously with the filing of the federal action on June 16, 1970 and prior to the argument of respondent's motion for summary judgment in state court, petitioners

moved in the District Court, pursuant to Rule 65 of the Federal Rules of Civil Procedure, to enjoin the state action on the ground that a judgment in that action would necessarily oust the federal court of jurisdiction to decide petitioners' federal claims and would prevent petitioners from obtaining the federal securities law relief to which they are entitled. Petitioners also sought a temporary restraining order, which was denied by the District Court.

On June 24, 1970, petitioners' motion for a preliminary injunction was argued before Judge Morris E. Lasker of the District Court who reserved decision. While that motion was *sub judice*, Justice Nathaniel Helman in the state court, by decision dated July 16, 1970, granted respondent partial summary judgment in the sum of $1,008,598.27. Justice Helman's decision necessarily decided the following factual issues: (1) that the Agreement is valid and enforceable in all respects; (2) that petitioners are not entitled to rescission of the Agreement; (3) that petitioners' claims are illusory; that petitioners' multiple of earnings/multiple of damages theory is without merit; (4) that the amount of petitioners' damages is minimal and (5) that since the proper measure of damages incurred by petitioners is the balance sheet misrepresentation figure set forth in petitioners' enumeration of determinable damages ($64,481.36), and not the indeterminable amount asserted by petitioners, the representation relating to the truth and accuracy of respondent's earnings and financial condition of his former company had in effect been "read out" of the Agreement (212-218).

By written decision of July 27, 1970, Judge Lasker of the District Court granted petitioners' motion for a preliminary injunction and stayed respondent and his attorneys from continuing the prosecution of the state court action pending the disposition of the federal proceedings (219-231). By order dated July 31, 1970, Judge Lasker required petitioners to post a bond in the sum of

$1,008,598.27, the amount determined in the state court decision, and petitioners filed a bond in this amount on August 5, 1970 (264).

Since the federal court action arises out of the same facts and transactions as the state action, but is premised upon the federally exclusive remedies provided in Sections 10(b) and 29(b) of the Act, Judge Lasker concluded that if the entry of the state court judgment were not prevented, petitioners would be collaterally estopped from proceeding in the federal action. Specifically, Judge Lasker held:

> "If [respondent] is permitted to proceed to enter judgment on the basis of the state court's opinion, the question arises as to whether [petitioners] will be collaterally estopped from establishing [their] right, under the federal law, to rescission and damages. It seems to me that in these circumstances [petitioners] will be estopped from establishing [their] multiple-of-earnings / multiple-of-damages theory, and that the consequence of such estoppel would be to deprive this court of its exclusive jurisdiction to determine claims arising under the federal securities laws and to fashion an appropriate remedy under those laws" (225).

The District Court also concluded that the Anti-Injunction Act (28 U.S.C. § 2283) did not operate as a bar to injunctive relief, since a stay of the state proceeding was "necessary in aid" of the federal court's *exclusive* jurisdiction to determine matters arising under the Act. Since the collateral estoppel and *res judicata* effects of a state court judgment would have the practical effect of ousting the District Court of its jurisdiction to determine federal claims, Judge Lasker concluded that if the state judgment were entered, petitioners' federal claims would never be litigated:

> "It follows that although the subject matter presented to the state court is for all practical purposes identical to the subject matter of the case

> before me, [petitioners have] not had and cannot have the opportunity to present to the state court [their] claims under Sections 10(b) and 29(b) of the Securities Act" (224).

On March 5, 1971, the United States Court of Appeals for the Second Circuit reversed the preliminary injunction granted in favor of petitioners and remanded the case to the District Court. In reversing the injunctive relief, the Circuit Court made it plain that the policy of 28 U.S.C. § 2283 did not require a stay of the state court proceedings since there was no real or potential conflict threatening the authority of the federal court. Specifically, the Circuit Court held "[t]he only conceivable interference here would be an attempt by the state court to determine issues of federal law, a task which it certainly has not yet undertaken and which in any event would be wholly without effect." Additionally, with respect to petitioners' argument that § 21(e) of the Act (15 U.S.C. § 78(u)) authorized the injunction in this action, the Circuit Court concluded that "[t]he plain wording of that statute would seem to foreclose [petitioners'] contention."

Reasons for Granting the Writ

This case raises significant questions involving the enforcement and interpretation of the exclusive federal securities laws rights and remedies, particularly the provisions of Sections 10(b) and 29(b) of the Act and the interplay of state and federal jurisdiction over violations thereof. Aside from the substantial questions involved in this case, petitioners believe that the decision of the Second Circuit Court of Appeals is in conflict with this Court's recent decision in *Atlantic Coast Line Railroad Co.* v. *Brotherhood of Locomotive Engineers,* 398 U.S. 281 (1970).

1. The Anti-Injunction Act, 28 U.S.C. § 2283, should not operate as a bar to the issuance of an injunction in the District Court by reason of the possible collateral estoppel and *res judicata* effects of a state court judgment.

Precedent is legion for the proposition that a prior state court judgment with respect to a breach of contract or common law fraud claim will preclude relitigation of the facts and issues underpinning either of those claims when asserted in the context of a Section 10(b) or Rule 10b-5(17 C.F.R. 240.10b-5) federally exclusive cause of action in the federal courts.

Dembitzer v. *The First Republic Corp. of America,* CCH Fed. Sec. L. Rep. ¶ 91,556 (S.D.N.Y. 1965), (not otherwise reported);

Kaufman v. *Shoenberg,* 154 F.Supp. 61 (D. Del. 1954);

Boothe v. *Baker Industries, Inc.,* 252 F.Supp. 168 (D. Del. 1966);

Connelly v. *Balkwill,* 174 F.Supp. 49 (N.D. Ohio 1959), *aff'd* 279 F.2d 685 (6th Cir. 1960);

Abramson v. *Pennwood Investment Corp.,* 392 F.2d 759 (2d Cir. 1968);

Wellington Computer Graphics, Inc. v. *Modell,* 315 F.Supp. 24 (S.D.N.Y. 1970);

Klein v. *Spear, Leeds & Kellogg,* 306 F.Supp. 743, 747 (S.D.N.Y. 1969).

The District Court relied on the decisions of *Connelly* v. *Balkwill, supra, Kaufman* v. *Shoenberg, supra* and *Boothe* v. *Baker Industries, Inc., supra* to support the proposition that petitioners would be collaterally estopped from establishing their right, under exclusive governing federal law, to rescission and damages, if respondent were permitted to enter his judgment in the state court action. Since petitioners' counterclaims in the state action arise out of the same factual complex as their claims in the federal court, the District Court concluded that its jurisdiction to determine

the federally exclusive claims would be ousted after a judgment were entered on the state court decision.

Boothe v. *Baker Industries, Inc., supra,* a decision relied upon by the District Court, is illustrative of the above decisions. In *Boothe* the District Court determined under the principals of *res judicata* and collateral estoppel, that a prior state court judgment operated as a bar to a subsequent Section 10(b) action in the federal court arising on the identical facts. Plaintiff in *Boothe* alleged a cause of action under Section 10(b) and Rule 10b-5 as well as Section 29(b) of the Act. Relying on the "full faith and credit clause" of the United States Constitution, Article IV, Section I, and the implementing statute, 28 U.S.C. § 1738, the District Court concluded that it was required to give the state court judgment the same force and effect it would have in the courts of the state where it was rendered.

Granting summary judgment for the defendant in the federal action, the *Boothe* court determined that two issues were actually litigated and determined in the state action: (1) the validity of a proxy statement, and (2) the fairness of a merger. In face of this prior adjudication, the District Court determined that it could not possibly find a violation of Section 10(b) or the proxy rules under the Act without "cutting the heart out of the [state court] judgment." In dismissing the federal complaint, the District Court concluded:

> "There is no reason of public policy why a final judgment such as was entered in the [state court] case should not bar further action by a stockholder attacking the same transactions whether by means of a derivative, non-derivative, or individual suit, where the prior judgment fairly interpreted, purports to do so, as does the [state court] judgment. Indeed, the desirability of ending litigation once and for all supports the view that the principle of *res judicata* or at least the narrower principle of estoppel by judgment as to matters actually litigated and decided, should be applied." *Id.* at 175.

Thus, since there exists a grave danger to petitioners that a collateral estoppel or *res judicata* effect may result from the entry of respondent's state court judgment, it is plain to see that the federal court, the exclusive forum to decide claims arising under petitioners' anti-fraud and rescission claims premised on §§ 10(b) and 29(b) of the Act, will be ousted of its jurisdiction to determine these claims.

Since petitioners believe that to permit the entry of a state court judgment where there are validly asserted federal securities law claims has the practical effect of depriving the federal court of jurisdiction to determine petitioners' claims, it is petitioners' position that the injunction should have remained in effect during the pendency of the federal proceedings in aid of the District Court's jurisdiction. The sole issue, therefore, is whether the Anti-Injunction Act, 28 U.S.C. § 2283, operates as a bar to the issuance of the injunction.

28 U.S.C. § 2283 provides:

> "A court of the United States may not grant an injunction to stay proceedings in a State court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments."

Judge Lasker held that the "aid of its jurisdiction" exception was applicable and constituted the basis for the entry of the injunction—that since the federal courts have exclusive jurisdiction to determine violations under Sections 10(b) and 29(b) of the Act, the injunction was necessary to aid the federal court to exercise its jurisdiction, *i.e.*, that without such injunction, the federal court would be divested of its power.

In reaching his decision, Judge Lasker relied on this Court's recent decision in *Atlantic Coast Line Railroad Co.* v. *Brotherhood of Locomotive Engineers*, 398 U.S. 281 (1970) in which this Court held that an injunction had been

unwarranted under the facts involved, but cogently stated the rule to be:

> "[I]f the District Court does have jurisdiction, it is not enough that the requested injunction is related to that jurisdiction, but it must be *'necessary in aid of'* that jurisdiction. While this language is admittedly broad, we conclude that it implies something similar to the concept of injunctions to 'protect or effectuate' judgments. *Both exceptions to the general prohibition of § 2283 imply that some federal injunctive relief may be necessary to prevent a state court from so interfering with the federal court's consideration or disposition of the case as to seriously impair the federal court's flexibility and authority to decide that case.*" *Id.* at 295. [Emphasis supplied]

In short, petitioners contend that the entry of the state court judgment in the related action probably will cause an ouster of the federal court's jurisdiction to decide petitioners' federal claims by reason of the collateral estoppel and *res judicata* effects resulting from the state court judgment. Therefore, it is clear that the 2d Circuit's opinion flies directly in the face of this Court's decision in *Atlantic Coast Line Railroad Co.* v. *Brotherhood of Locomotive Engineers, supra,* since reversal of the preliminary injunction will necessarily impair the federal court's jurisdiction to decide petitioners' federally exclusive claims. Unless the Circuit Court's decision is reversed, petitioners will be deprived of their exclusive federal rights, which strong public policy dictates that they be given an opportunity to exercise.

Additionally, a federal securities law plaintiff may be irreparably damaged if the issue of damages in a state court action may be determined differently there than in the federal court because the law of remedies under Rule 10b-5 is one of the most virgin areas of the law.* Thus, since state courts are not empowered to fashion broad remedies for securities violations, which may be provided in a federal action under § 10(b) and Rule 10b-5, petitioners

would have forfeited a right to which they were entitled under a federal statute. As the court observed in the recent case of *Gottlieb* v. *Sandia American Corp.*, 304 F. Supp. 980, 981 (E.D. Pa. 1969),

> "[B]ecause most 10b-5 cases to date have been settled or otherwise resolved at the pleading stage, the law regarding remedies is still at an inchoate stage of development. [Citations]"

Therefore, since there is a strong federal policy that the issue of damages involving federal securities law claims be decided in the federal court, the injunction should have been permitted to stand.

2. Section 21(e) of the Act (15 U.S.C. § 78u(e)) constitutes an "expressly authorized by Act of Congress" exception to 28 U.S.C. § 2283 and the injunction should therefore have been permitted to stand.

Section 21(e) of the Act provides:

> "Whenever it shall appear to the Commission that any person is *engaged or about to engage in* any acts or practices which constitute or will constitute a violation of the provisions of the Act, or any rule or regulation thereunder, it may . . . bring an action . . . to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond." [Emphasis supplied.]

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* Petitioners have alleged that their damages were "indeterminate." Judge Helman rejected that argument and applied only a "Balance Sheet" test to measure damages flowing from the misrepresentations. Judge Helman's novel decision, if permitted to stand, not only rejects the multiple of earnings/multiple of damages theory, but in addition forecloses any reliance upon the profit and loss warranty made by respondent in the Agreement. Thus, the decision could become precedent for the clearly erroneous proposition that misrepresentations made as to the earnings of a business which is sold, are irrelevant to the determination of damages suffered by the buyer.

Relying on the decision of *Studebaker Corporation* v. *Gittlin*, 360 F.2d 692 (2d Cir. 1966), petitioners argued in the District Court that the injunction should issue to prevent respondent from reaping in the state court the illegal gains resulting from the fraud he perpetrated on petitioners. The Second Circuit in *Studebaker Corporation* v. *Gittlin, supra*, held that Section 21(e) of the Act permitted a private litigant to enjoin a state proceeding where a violation under the Act had occurred, on the ground that the injunction was "expressly authorized by Act of Congress" within the meaning of Section 2283.

Petitioners believe the *Studebaker* decision to be applicable here. Both in *Studebaker* and the instant matter the federal litigants were seeking to enforce the federal securities laws by preventing a violation of the Act, which would have been the result if the state court were permitted to grant the requested relief to the state court plaintiff. In the instant action, since it is charged that respondent has made false representations and nondisclosures in connection with the Agreement, and therefore his conduct was unlawful within the meaning of Section 10(b) and Rule 10b-5, the Agreement is void or voidable at the option of respondent under Section 29(b) of the Act. Hence, respondent's state court action is merely an attempt by him to circumvent the effects of Sections 10(b) and 29(b) of the Act, two federally exclusive claims, which *cannot* and *will not* be recognized by a state court * in a breach of contract claim arising out of an allegedly illegal agreement.

Thus, petitioners' efforts to stay the state court action are really an *enforcement* of the federal securities laws,

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* *American Distilling Co.* v. *Brown*, 295 N.Y. 36, 64 N.E. 2d 347 (1945); *McCollum* v. *Billings*, 53 Misc. 2d 661, 279 N.Y.S. 2d 609 (Sup. Ct. Onondaga Co. 1967); *MeKrut* v. *Gould*, 16 Misc. 2d 326, 188 N.Y.S. 2d 6 (Sup. Ct. N.Y. Co. 1959); *White* v. *Ludwig*, 32 Misc. 2d 120, 223 N.Y.S. 2d 316 (Sup. Ct. N.Y. Co. 1961), *aff'd without opinion*, 253 N.Y.S. 2d 524 (1st Dept. 1964).

since, as the state court opinion demonstrates, an allegedly illegal contract may be enforced under state law but will not be enforced under federal law due to Sections 10(b) and 29(b) of the Act.

Petitioners, therefore, believe that the Second Court improperly circumscribed the holding in *Studebaker Corporation* v. *Gittlin*, *supra*, and that the holding and rationale of that case should have caused the Circuit Court to affirm the grant of the preliminary injunction by the District Court.

CONCLUSION

For the reasons set forth above, a writ of certiorari should issue to review the judgment and opinion of the Second Circuit.

Respectfully submitted,

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March 1971

(APPENDIX)

Opinion of Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 400 September Term, 1970

(Argued January 19, 1971. Decided March 5, 1971)

Docket No. 35375

VERNITRON CORPORATION & AMERICAN MEDICAL INSTRUMENT CORPORATION,

Plaintiff-Appellees,

against

PAUL BENJAMIN,

Defendant-Appellant.

Before:

HAYS and ANDERSON, *Circuit Judges,* and TYLER, *District Judge.**

Appeal from an order of the United States District Court for the Southern District of New York, Morris E. Lasker, District Judge, staying prosecution of an action in the Supreme Court of New York, New York County. Reversed and remanded.

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* Sitting by designation.

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CHARLES H. MILLER, New York, N. Y. (MARSHALL, BRATTER, GREENE, ALLISON & TUCKER, New York, N. Y., ARTHUR J. GINSBURG, on the brief) for appellees.

TYLER, *District Judge*

Defendant-appellant ("Benjamin") appeals from an order of the District Court for the Southern District of New York granting a preliminary injunction against his continued prosecution of an action in the Supreme Court of New York, New York County, against plaintiff-appellees ("Vernitron") and their attorneys (in their capacity as escrow agent).

In December, 1967, Benjamin executed a written contract with Vernitron for the sale of all the assets of his wholly-owned corporation, American Medical Instrument Corporation ("Amico"). The original contract provided that Benjamin was to receive $1,500,000 worth of Vernitron common stock; six months later, by mutual agreement, that figure was reduced to $1,300,000. The contract provided that the stock was to be held in escrow by Vernitron's attorneys. During the thirteen months immediately following the sale, Benjamin could demand the registration of $250,000 worth of these shares, the number of such shares to be determined by the closing price of Vernitron shares on the American Stock Exchange just prior to the expected effective date of registration. Pursuant to these terms, in June 1968, Benjamin secured the registration of and sold slightly less than $250,000 worth of stock. On February 1, 1969, Benjamin requested the registration of the balance of the shares, approximately $1,050,000 worth. To date Vernitron has failed or refused to register those remaining shares.

On November 6, 1969 Benjamin commenced an action against Vernitron in the state court alleging breach of contract. Vernitron counterclaimed, alleging breaches of eight warranties and demanding rescission for failure of consideration.

Following some discovery, on June 2, 1969, Benjamin moved for summary judgment at Special Term of the Supreme Court of New York. On June 16, three days before the adjourned return date of Benjamin's motion, Vernitron commenced this federal action wherein allegations essentially the same as its counterclaims in the state court are pleaded; in addition, the complaint pleads violations of Sections 10(b) and 29(b) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78cc(b), and common law fraud. At the same time, Vernitron brought on a motion for a preliminary injunction staying further proceedings in the state court and requesting immediate issuance of a temporary restraining order. The district court refused to issue the temporary restraining order on June 16, and three days later Benjamin's summary judgment motion was argued before Mr. Justice Helman at Special Term.

On July 16, 1970, Justice Helman filed a decision granting Benjamin partial summary judgment and denying Vernitron's motion for a stay of the state court suit. He granted partial summary judgment in the amount of $1,050,000, less the approximate sum of $42,000 which he found to be the maximum alleged value of Vernitron's counterclaims.[1] In granting partial summary judgment, Justice Helman ruled that there were insufficient factual allegations to support Vernitron's claims of "indeterminate damage" and its right to rescission.

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[1] New York CPLR § 3212(e) provides in pertinent part that ". . . in any action summary judgment may be granted as to one or more causes of action, or part thereof, in favor of any one or more parties, to the extent warranted, on such terms as may be just."

On July 27, before judgment could be entered on the basis of the opinion of Special Term, the district court filed its opinion granting Vernitron's motion for a preliminary injunction, staying Benjamin and his attorneys "during the pendency of this action from taking any steps or proceedings in the prosecution of the lawsuit" in the state court.

The district judge was of the opinion that a stay of the state court action fell within an exception to the anti-injunction statute, 28 U.S.C. §2283, as "necessary in aid" of the federal court's exclusive jurisdiction over matters arising under the Securities Exchange Act of 1934, as provided in Section 27. 15 U.S.C. § 78aa. He reasoned that any factual issues determined in the state court would have a collateral estoppel effect in the federal litigation—e.g. that Vernitron would be estopped from establishing facts determined against it in the state litigation though relevant to its rights under federal law. He concluded that the net effect of such estoppel would be to deprive the federal court of its exclusive jurisdiction over Securities Exchange Act claims.

We disagree with this ultimate conclusion. There can be no question but that the doctrine of collateral estoppel would be applied in any instance where the state court had determined a factual issue arising in a subsequent federal litigation. *Restatement of Judgments*, Chap. 3, § 68(1) (1942); *e.g. Connelly* v. *Balkwill*, 174 F. Supp. 49 (N.D. Ohio 1959). But, to justify an injunction of a state court action, "[i]t is not sufficient to show that the matter properly before a state court embraces issues within the compass of the federal suit, even if the federal court has exclusive jurisdiction over its case." *Greater Continental Corporation* v. *Schechter*, 304 F. Supp. 325, 330 (S.D.N.Y. 1969); appeal dismissed 422 F.2d 1100 (2 Cir. 1970); *accord*, *Lyons* v. *Westinghouse*, 201 F. 2d 510 (2 Cir. 1953). There

is no reason why the state court cannot or should not determine issues of fact and state law relevant thereto as they come up in the state litigation. The subsequent effect of collateral estoppel, far from requiring the federal court to stay proceedings in the state court, is a result which should be welcomed to avoid the task of reconsidering issues which have already been settled by another competent tribunal. *Klein* v. *Walston*, 432 F. 2d 936 (2 Cir. 1970); see, generally, *Restatement of Judgments*, Chap. 3, § 70 (1942).[2]

The policy of the anti-injunction statute, 28 U.S.C. § 2283, is to prohibit enjoining of state court suits except in those situations where the real or potential conflict threatens the very authority of the federal court. The only conceivable interference here would be an attempt by the state court to determine issues of federal law, a task which it certainly has not as yet undertaken and which in any event would be wholly without effect.

As to the other exceptions to Section 2283, there is no contention that an injunction is "necessary . . . to protect or effectuate" a judgment of a court of the United States." Vernitron, however, argues that an injunction is warranted by a third exception, "as expressly authorized by Act of Congress." Specifically, it relies on Section 21(e) of the Securities Exchange Act (15 U.S.C. §78u) authorizing the SEC to obtain an injunction against persons "engaged or about to engage" in acts in violation of the Securities Exchange Act. The plain wording of that statute would seem to foreclose Vernitron's contention. Moreover, *Studebaker Corporation* v. *Gittlin*, 360 F. 2d 692 (2 Cir. 1966), relied upon by Vernitron is inapposite in that the

[2] It is perhaps worth noting that the decision of this court in *Klein* v. *Walston* came down after the opinion of the district court in this case.

prosecution of the state action there relevant would itself have furthered the violation of the Securities Exchange Act.

Finally, Vernitron should not be permitted to use the exceptions to Section 2283 as a means of avoiding an adverse state decision and in effect obtaining appellate review thereof in a federal district court. See, *e.g. Atlantic Coast Line Railroad Co.* v. *Brotherhood of Locomotive Engineers*, 398 U.S. 281 (1970).

Reversed and remanded with the direction to forthwith vacate the stay order.

Memorandum Opinion of Lasker, *D. J.*

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

70 Civ. 2518

VERNITRON CORPORATION and AMERICAN MEDICAL INSTRUMENT CORPORATION,

Plaintiffs,

against

PAUL BENJAMIN,

Defendant.

Appearances:

MARSHALL, BRATTER, GREENE, ALLISON & TUCKER, 430 Park Avenue, New York, N. Y. 10022, Attorneys for Plaintiffs, of Counsel CHARLES H. MILLER, RICHARD L. BOND, ARTHUR J. GINSBURG.

PAUL, WEISS, GOLDBERG, RIFKIND, WHARTON & GARRISON, 345 Park Avenue, New York, N. Y. 10022, Attorneys for Defendant, of Counsel EDWARD N. COSTIKYAN, JOEL S. TAYLOR.

LASKER, *D.J.*

Plaintiffs move for an order restraining the defendant and his attorneys from taking any steps or proceedings in the prosecution of a lawsuit now pending in the Supreme Court of the State of New York, County of New York, between the same parties, entitled "Paul Benjamin v. Vernitron Corporation, et al." In order to avoid the confusion which would arise by referring to the parties either as

plaintiff or defendant (since Vernitron, et al., are plaintiffs here and defendants in the state court action, whereas Paul Benjamin is defendant here and, with others, plaintiff in the state court), references will be made to the parties by name.

I.

On December 20, 1967, Vernitron (a New York corporation since acquired by Vernitron, a Delaware corporation) and its affiliate entered into a written contract with Benjamin and his wholly-owned corporation, American Medical Instruments Corporation ("Amico") for sale of all the assets of Amico to the affiliate of Vernitron New York. The contract provided that Benjamin was to receive $1.5 million worth (later reduced to $1.3 million) of Vernitron common stock which was to be placed in escrow with Vernitron's attorneys, Marshall, Bratter, Greene, Allison & Tucker under prescribed conditions. The contract specified a procedure for the registration by Vernitron of the shares held in escrow for Benjamin. Pursuant to these terms, Benjamin secured the registration of slightly less than $250,000 worth of shares. In February 1969, Benjamin requested (as he had the right to) that the remainder of the shares be registered, but Vernitron refused.

On November 6, 1969, Benjamin brought suit in the Supreme Court of the State of New York, County of New York, against Vernitron, its affiliate, and Marshall, Bratter, Greene, Allison & Tucker as escrow agent. This is the action the prosecution of which Vernitron now asks this court to enjoin. In his state court suit Benjamin set forth causes of action for (1) damages of $1,050,000 for failure to register the remaining shares in escrow; (2) damages for failure to place further stock in escrow in order to total $1.3 million in value; (3) specific performance of the contract, delivery of the shares and dividends thereon; and

(4) exemplary damages. Vernitron counterclaimed, alleging breach of warranty by Benjamin and demanding rescission of the contract for failure of consideration. On June 2, 1970, Benjamin served notice of motion in the state court action for summary judgment in the amount of $1,051,085.63 on the first cause of action (together with severance thereof from the remaining causes of action).

On June 16, 1970, Vernitron commenced the instant action against Benjamin and simultaneously or at about the same time moved in the state court for a stay of further proceedings therein pending the determination of the federal court action.

In the case here, Vernitron alleges violations of Sections 10(b) and 29(b) of the Securities Exchange Act of 1934, as well as (under the pendent jurisdiction of this court) common law fraud and breach of contract. The complaint requests rescission of the contract and damages. As stated above, the instant motion asks that Benjamin and his attorneys be stayed from proceeding with the prosecution of the state case. It is Vernitron's contention that a stay of the state court proceedings is proper because a potential conflict between the state and federal jurisdictions exists, since the issues relating to its counterclaim in the state court may be decided there in such a way as to constitute *res judicata*, or so as collaterally to estop Vernitron from presenting its Securities Exchange Act claims to this court.

In reply, Benjamin argues that whatever determination may be made on his motion for summary judgment in the state court will not constitute *res judicata* or collaterally estop Vernitron from litigating its Securities Act claims here, and that in any event the anti-injunction statute, set forth in Title 28, U.S.C. § 2283, acts as a bar to this court's granting an injunction against prosecution of the state court action.

In passing, it should be noted that at the time of the argument in this court of the motion for a stay of the state court proceeding the state court had rendered no decision on Benjamin's motion for partial summary judgment, nor on Vernitron's motion for a stay. On July 16, 1970, Mr. Justice Helman filed an opinion granting Benjamin substantially the relief requested in his motion, and denying Vernitron a stay. No judgment has yet been entered pursuant to the opinion. In his decision Justice Helman found that Vernitron's damages, if any, were not, as alleged, indeterminable but, rather, ascertainable. Without a detailed explanation he ruled "as being properly placed in issue the sum of $42,487.36 as the sum in dispute", as to Benjamin's alleged breach of warranties, that the alleged breach of warranty even in the claimed amount of $65,000 could "hardly be said to constitute failure of consideration"; that there was insufficient factual data contained in Vernitron's affidavits to warrant rescission, and that the Vernitron-Benjamin contract price was not computed on the basis of a multiple of Amico's earnings. His award was in the amount of the relief requested ($1,051,085.63) less the contested claim of $42,487.36 for breach of warranty.

II.

The issues before me are (A) whether the anti-injunction statute stands as a bar to granting an injunction against prosecution of the state court proceeding; and (B) whether, even if there is no such bar, an injunction should be granted in accordance with general equitable considerations.

(A) *The Anti-Injunction Statute*

Title 28, U.S.C. § 2283, reads:

> "A court of the United States may not grant an injunction to stay proceedings in a State Court ex-

> cept as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments."

There is no contention that any judgment of this court exists, and consequently the third exception to the rule is inapplicable here.

Vernitron contends, under the authority of *Studebaker Corporation* v. *Gittlin*, 360 F.2d 692 (2d Cir. 1966), that there is a basis for private plaintiffs to come within the "expressly authorized" exception of 28 U.S.C. § 2283. Benjamin vigorously contests this reading of *Studebaker*, which held that under the provision of Section 21(e) of the Securities Exchange Act (15 U.S.C. § 78u) authorizing the SEC to obtain injunction against persons "engaged or about to engage" in acts in violation of the Securities Exchange Act, circumstances could exist constituting a basis for private plaintiffs to come within the "expressly authorized" exception to 28 U.S.C. § 2283.

In view of the disposition of the case set forth below, I find it unnecessary to determine whether the rule of *Studebaker* applies here except to note my skepticism that it does, in view of the substantial factual differences between the instant case and *Studebaker*.

This brings me to the determination of whether an injunction to stay the state court proceeding is authorized here as "necessary in aid" of this court's jurisdiction. I start from the significant proposition that *exclusive* jurisdiction to determine matters arising under the Securities Exchange Act of 1934 is vested in the federal courts. 15 U.S.C. § 78aa. It follows that, although the subject matter presented to the state court is for all practical purposes identical with the subject matter of the case before me, Vernitron has not had and cannot have

the opportunity to present to the state court its claims under Sections 10(b) and 29(b) of the Securities Act.

In the state court proceeding Justice Helman has already held that, under New York law, even if Vernitron can prove a case of fraud, there is no ground for rescission of the contract, and that damages for substantially the full amount requested by Benjamin are payable. He has also found that the parties did not enter into the contract on the basis upon which Vernitron claims they both relied. In this regard, Justice Helman's conclusion that there was no multiple-of-earnings basis for the contract price is especially significant, since the underpinning of Vernitron's federal claim for rescission is based on its allegation that the sales price *was* premised on an earnings multiple. Vernitron claims that its damages have been so multiplied by Benjamin's alleged misstatement of earnings that rescission is the only adequate remedy.

If Benjamin is permitted to proceed to enter judgment on the basis of the state court's opinion, the question arises as to whether Vernitron will be collaterally estopped from establishing its right, under federal law, to rescission and damages. It seems to me that in these circumstances Vernitron would be estopped from establishing its multiple-of-earnings/multiple-of-damages theory, and that the consequence of such estoppel would be to deprive this court of its exclusive jurisdiction to determine claims arising under the federal securities laws and to fashion an appropriate remedy under those laws. *Connelly* v. *Balkwill,* 174 F.Supp. 49 (N.D. Ohio 1959), aff'd 279 F.2d 685 (6th Cir. 1960); *Kaufman* v. *Shoenberg,* 154 F.Supp. 64 (D. Del. 1954) (relating to *res judicata* as distinguished from collateral estoppel); *Boothe* v. *Baker Industries, Inc.,* 262 F.Supp. 168 (D. Del. 1966).

The situation here presented is similar to the one analyzed by the Court of Appeals of this Circuit in *Greater Continental Corp.* v. *Schechter,* 422 F.2d 1100 (2d Cir.

1970). Although that opinion did not involve the anti-injunction statute, the court dealt with the analogous situation of a stay of arbitration. Holding that a stay of arbitration would be appropriate in connection with securities fraud cases, the court observed (at 1103-4):

> "The fraud issues involved in this case are within the view of Rule 10b-5, and the threat to Schechter's employment arises out of questions concerning the validity of the stock sale out of which the employment arose. Where, as here, there may be later conflicting claims of lack of jurisdiction on the part of the arbitrator, on the one hand, and of a collateral estoppel effect following the arbitrator's decision on the fraud issues, on the other, see James L. Saphier Agency, Inc. v. Green, 190 F.Supp. 713 (S.D.N.Y. 1961), aff'd 293 F.2d 769 (2d Cir. 1961); cf. Liquifuels, Inc. v. Hess Oil & Chemical Co., 281 F.Supp. 596 (S.D.N.Y. 1968), the court should consider whether the better course would not be to stay the arbitration proceeding pending prompt federal litigation of the fraud issue (i.e., disposition of Continental's claims in this suit), with expedited trial.
>
> "In this and similar cases involving fraud questions under the securities acts of 1933 and 1934, where there is a *strong federal policy in favor of determining stock fraud questions in the federal courts*, see Wilko v. Swann, *supra*, arbitration of the subsidiary employment issues which will necessarily determine the fraud questions also, may well be stayed." (Emphasis added.)

See also *Wellington Computer Graphics, Inc.* v. *Modell*, CCH Fed. Sec. L. Rep. ¶ 92,702 (S.D.N.Y. July 2, 1970), in which Judge MacMahon observed that a final judgment in the state court relating to matters also covered by the federal securities laws "would collaterally estop relitigation here of issues common to both actions."

In reaching the conclusion that the anti-injunction statute does not bar the issuance of an order restraining fur-

ther proceedings in the state case, I am not unmindful of the limitations placed by the Supreme Court in its opinion in *Atlantic Coast Line Railroad Co.* v. *Brotherhood of Locomotive Engineers, et al,* 38 LW 4471 (June 8, 1970), on the granting of such injunctions. However, analysis of the facts of the instant case persuades me that it is not embraced within the limitations set forth in *Atlantic.* As Mr. Justice Black wrote, the facts in *Atlantic* established that

> "In short the state and federal courts had concurrent jurisdiction in this case, and neither court was free to prevent either party from simultaneously pursuing claims in both courts. [citing cases] Therefore, the state court's assumption of jurisdiction over the state law claims and the federal preclusion issue did not hinder the federal court's jurisdiction so as to make an injunction *necessary* to aid that jurisdiction." (Emphasis in original.)

Here, however, the state court does *not* have concurrent jurisdiction with the federal court as to the Securities Exchange Act claims, and cannot and did not rule on them. But the ruling which it has handed down could well act collaterally to estop Vernitron from establishing its federal claims in this court. Accordingly, in the present circumstances, unlike *Atlantic,* an injunction appears necessary in aid of this court's jurisdiction.

(B) *General Equitable Concessions*

Having determined that the anti-injunction statute does not stand as a bar to granting the relief requested on this motion, it is necessary to apply the equitable standards by which the propriety of the issuance of an injunction is normally measured. The ordinary prerequisites to the granting of a preliminary injunction are a finding that the plaintiff will probably succeed on the merits of the case and

that without such relief it will be irreparably damaged. *Studebaker Corporation* v. *Gittlin, supra; Symington Wayne Corp.* v. *Dresser Industries, Inc.*, 383 F.2d 840 (2d Cir. 1967).

I find that the plaintiff here would be irreparably damaged if an injunction were not issued, since it would suffer the substantial risk of being collaterally estopped from presenting to this court its claims under the Securities Exchange Act.[1]

As to the probability of plaintiff's succeeding on the merits of the case, it must be conceded that Justice Helman's decision raises doubt. However, it is to be observed that Justice Helman did not, as he could not, rule on the plaintiff's causes of action under Sections 10(b) and 29(b) of the Act. Since, however, plaintiff in a federal securities case need not prove scienter, whereas he must do so under state law, the state court opinion does not compel the conclusion that Vernitron will fail to prove its case here. If the facts are as alleged by Vernitron (which is vigorously disputed by Benjamin), a violation of the Act would probably be established. That prospect appears to me to be sufficiently real to justify permitting Vernitron its day in federal court. This view is consistent with the attitude expressed by the Court of Appeals for this Circuit in *Semmes Motors, Inc., et al.* v. *Ford Motor Company* (Slip Opin. July 6, 1970, Dkt. No. 34447). There, relying on the landmark opinion of *Hamilton Watch Co.* v. *Benrus Watch Co.*, 206 F.2d 738, 740 (2d Cir. 1953), the court said:

> "In light of the imbalance of hardship, affirmance of the temporary injunction does not depend on a holding that Semmes had demonstrated a likelihood of success; it is necessary only that Semmes 'has raised questions going to the merits so serious, substantial, difficult and doubtful as to make them a fair ground for litigation and thus for more deliberate investigation, . . .'

Memorandum Opinion of Lasker, D. J.

Refusal to restrain the state court proceeding here would prevent Vernitron from having its day in federal court on federal claims of which federal courts have exclusive jurisdiction. Granting the stay will impose on Benjamin the necessity of proving his claims on their merits under the securities laws. An additional factor of damage to Vernitron in denying the injunction would be that it would have to pay to Benjamin over $1 million, which, if it prevails on its suit here, it will of course not be required to do. Accordingly, I find that the imbalance of hardship favors Vernitron. Since it has in my opinion also raised questions on the merits sufficiently serious to call for more deliberate investigation, I find that an injunction should be granted restraining Benjamin and his attorneys from further prosecution of the state court action. However, in view of the fact that Vernitron did take seven months to institute this federal court action, and that Justice Helman has rendered a decision adverse to Vernitron in the state court, the motion to be granted here will be conditioned upon Vernitron's furnishing a sufficient bond the amount of which will be determined by the court upon submission of appropriate documentation by the parties. The parties shall submit such material forthwith.

For the reasons and upon the conditions stated above the motion is granted.

Pursuant to Rule 52(a), this opinion constitutes the findings of fact and conclusions of law of the court.

Settle order on notice.

Dated: New York, N. Y.
July 27, 1970

MORRIS E. LASKER
U.S.D.J.

FOOTNOTE

1. Benjamin contends that in taking seven months to bring this federal action Vernitron is guilty of laches such as to warrant a denial of preliminary relief. Certainly Vernitron's delay in instituting the federal suit is a relevant equitable consideration, but I am not persuaded that it is of sufficient weight to warrant a denial of a preliminary injunction if all the other factors by which the granting of preliminary relief is measured are satisfied. None of the cases cited by Benjamin as support for his proposition that delay on the part of a plaintiff constitutes grounds for refusal to grant a preliminary injunction is controlling here. All of those cases involved claims of trademark or copyright infringement in which it was found that the plaintiff's delay in seeking preliminary relief in itself proved that the damage suffered could not be serious. But claims of trademark or copyright infringement constitute a source of continuing damage, and it is quite proper to hold in such cases that a failure to seek preliminary relief may constitute an admission that the continuing damage is not serious. Here we are not dealing with a question of continuing damage. Furthermore, the failure to grant a preliminary injunction in the trademark or copyright infringement cases in no instance put the plaintiff out of court, whereas in the instant case failure to grant such preliminary relief would have precisely the result of collaterally estopping Vernitron from litigating its 10(b) and 29(b) claims.

Statutes and Regulations

15 U.S.C. § 78j:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

15 U.S.C. § 78u(e):

"Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the tices which constitute or will constitute a violation of the p provisions of this chapter, or of any rule or regulation thereunder, it may . . . bring an action . . . to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. . . ."

15 U.S.C. § 78cc(b):

"Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder, and every contract (including any contract for listing a security

on an exchange) heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, or regulation: . . ."

28 U.S.C. § 1738:

"The acts of the legislature of any State, Territory, or Possession of the United States, or copies thereof, shall be authenticated by affixing the seal of such State, Territory or Possession thereto.

The records and judicial proceedings of any court of any such State, Territory or Possession, or copies thereof, shall be proved or admitted in other courts within the United States and its Territories and Possessions by the attestation of the clerk and seal of the court annexed, if a seal exists, together with a certificate of a judge of the court that the said attestation is in proper form.

Such Acts, records and judicial proceedings or copies thereof, so authenticated, shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken."

Statutes and Regulations

28 U.S.C. § 2283:

"A court of the United States may not grant an injunction to stay proceedings in a state court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments."

17 C.F.R. § 240.10b-5:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."

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IN THE

Supreme Court of the United States

October Term, 1970

No. 1493

VERNITRON CORPORATION and AMERICAN MEDICAL INSTRUMENT CORPORATION,
Petitioners,

against

PAUL BENJAMIN,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR RESPONDENT IN OPPOSITION

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April 19, 1971

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IN THE

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No. 1493

VERNITRON CORPORATION and AMERICAN MEDICAL INSTRUMENT CORPORATION,

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against

PAUL BENJAMIN,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR RESPONDENT IN OPPOSITION

Respondent respectfully prays that the Petition for a Writ of Certiorari to review the judgment and opinion of the United States Court of Appeals for the Second Circuit entered herein on March 5, 1971, be denied.

Counterstatement of Questions Presented

1. Whether the collateral estoppel effects of a state court judgment are such an interference with a federal court's exclusive jurisdiction over claims under the Securities Exchange Act of 1934 so as to bring a federal injunc-

tion against state court proceedings within an exception to the anti-injunction statute, 28 U.S.C. §2283, as being necessary in aid of the federal court's jurisdiction?

2. Whether §21(e) of the Securities Exchange Act of 1934, 15 U.S.C. §78u(e), is an Act of Congress, within the meaning of 28 U.S.C. §2283, expressly authorizing an entity other than the Securities Exchange Commission to enjoin state proceedings which do not themselves violate the Securities Exchange Act of 1934?

3. Whether the Petition has became moot by the vacation of the preliminary injunction issued by the District Court and subsequent entry of judgment in favor of respondent in the Supreme Court of the State of New York?

Statement of the Case

On December 28, 1967 respondent Paul Benjamin ("Benjamin"), by written agreement, sold his family business, American Medical Instrument Corporation, to the New York corporate predecessor of petitioner Vernitron Corporation ("Vernitron") and to its wholly-owned subsidiary, which then changed its name to American Medical Instrument Corporation ("Amico") and is now the other petitioner in this action (31-32).* Benjamin is presently 73 years old and is living in retirement in Florida.

Under the written agremeent, Benjamin was to receive $1,500,000 worth of Vernitron common stock which was to

* Unless otherwise designated, all references are to page numbers of respondent's Appendix filed with the United States Court of Appeals for the Second Circuit.

be placed in escrow with Vernitron's attorneys as escrow agents. After certain time periods, the agreement provided that Vernitron must register certain portions of the escrowed common stock at Benjamin's request so that it could be sold on his behalf. On February 1, 1969, pursuant to the agreement, Benjamin requested registration of all the common stock remaining in escrow, having a value of approximately $1,051,000. Under the agreement, Vernitron had five months within which to make a registration statement effective (32-34).

Vernitron concededly refused to include these remaining escrowed shares in a registration statement (20, 175), although it did file a registration statement with respect to other shares in August 1969 (36). In October 1969, the agreement required Vernitron and its law firm as escrow agents to deliver to Benjamin enough unregistered shares, whether in escrow or not, to make up the $1,051,000 balance of the purchase price. Vernitron and its law firm admittedly refused to deliver these shares to Benjamin after due demand had been made (35, 50-1, 95, 122, 135).

Consequently, on November 6, 1969, Benjamin instituted suit against Vernitron, Amico, and their law firm in the Supreme Court of the State of New York claiming breach of contract for failure to register the shares and for failure to make delivery of unregistered shares in October and claiming that Vernitron and Amico induced their law firm to breach the escrow agreement (105-114). Vernitron and Amico answered on December 31, 1969, asserting counterclaims for the alleged breach of eight warranties in the acquisition contract and asking damages or rescission (115-132). Only about $34,000 in actual damages were alleged,

as compared to Benjamin's claim in his first cause of action alone for about $1,051,000. Vernitron and Amico claimed additional as yet undetermined amounts of damages, although two years had elapsed since the closing date of the acquisition agreement. Benjamin denied all allegations of breach (138-140).

Discovery in the spring of 1970 indicated Vernitron's counterclaims to be worth no more than about $43,000 (150-171). Therefore, on June 2, 1970, Benjamin moved for summary judgment on his first cause of action against Vernitron for failure to register the shares. New York practice permits summary judgment to be awarded a plaintiff on his claim where there are no issues of fact, even in the face of counterclaims having issues of fact to be tried; however, the usual practice is to grant partial summary judgment to a plaintiff, severing that part of his claim as is deemed necessary to secure a defendant in the trial of his counterclaims. Benjamin did not move for summary judgment on any part of the counterclaims.

Vernitron and Amico's response to Benjamin's motion for summary judgment was suddenly to decide that their rights needed protection in federal court, although for six months they had been content with their counterclaims in state court. On June 16, 1970, three days before the adjourned return date of Benjamin's summary judgment motion, Vernitron and Amico instituted this action in the United States District Court for the Southern District of New York, setting forth the same allegations of fact set forth in their state counterclaims, but predicating their rights on the Securities Exchange Act of 1934, §10(b) (1-14). However, their damages were alleged to be of the

same approximate value as the damages Benjamin was seeking because it was claimed for the first time that they had arrived at a purchase price for Benjamin's company by employing a multiple-of-earnings formula, and that, therefore, their damages, which allegedly affected earnings in 1967, should be multiplied by the same multiple. Together with the institution of this suit, Vernitron and Amico sought a temporary restraining order and a preliminary injunction against Benjamin's prosecution of the state action.

After hearing argument and receiving briefs, U. S. District Judge Morris E. Lasker denied the application for a temporary restraining order, and argument of Benjamin's motion for summary judgment in the state action went ahead on June 19, 1970. On June 24, 1970 the motion for a preliminary injunction was argued before Judge Lasker who reserved decision. While this latter motion was *sub judice,* Justice Nathaniel T. Helman of the Supreme Court of the State of New York, by decision dated July 16, 1970, granted Benjamin partial summary judgment in the amount of $1,008,598.27 (212-18). This sum was arrived at by determining the maximum alleged value of Vernitron's counterclaims to be approximately $43,000 and subtracting this latter sum from the amount claimed by Benjamin in his first cause of action.

Justice Helman granted no summary relief on the counterclaims, but he did discount Vernitron's newly raised contention that a multiple-of-earnings formula was used to determine the purchase price of the acquisition and that, consequently, counterclaim damages should be multiplied by some number, alleged by Vernitron to be ten at some

times and to be some unspecified figure—other than ten—at others. Justice Helman noted that there was no mention of any such formula in the acquisition agreement (216-18).

Before Benjamin could enter an order and judgment upon Justice Helman's decision (Benjamin waited at the request of Judge Lasker), the District Court on July 27, 1970, granted petitioners' motion for a preliminary injunction and stayed respondent and his attorneys from continuing the prosecution of the state court action pending the disposition of the federal proceedings. After receiving information from Benjamin indicating that Vernitron's net income had fallen from over $4,000,000 to approximately $120,000 from the year ended December 28, 1968 to the year ended December 27, 1969, Judge Lasker required petitioners to post a bond in the full amount of Benjamin's award of summary judgment in the state action (250-1, 264). Benjamin promptly appealed from Judge Lasker's order of injunction.

Judge Lasker reasoned that an injunction against the state court proceedings was within an exception to the anti-injunction statute, 28 U.S.C. §2283, as necessary in aid of the federal court's exclusive jurisdiction over matters arising under the Securities Exchange Act of 1934. Judge Lasker seemed primarily concerned that a judgment in the state action on Benjamin's first cause of action would bar petitioners from establishing, if they could, their multiple-of-earnings theory of damages in federal court (Petition, p. 12a).

Benjamin appealed from Judge Lasker's order primarily on three grounds. He contended that the injunction

was not necessary in aid of exclusive federal jurisdiction over a Securities Exchange Act claim because fact-finding in a state court could not impair federal *jurisdiction,* but simply left fewer issues to be tried in the federal action. He also contended that Justice Helman in granting summary judgment only on Benjamin's first cause of action, and not on the counterclaims, decided no issues of fact (other than the undisputed non-registration of the shares) which would have a collateral estoppel effect on federal claims in federal court, and that Vernitron and Amico could prevent future fact-finding in the state action by simply not prosecuting their counterclaims therein. Finally, Benjamin contended that Judge Lasker had abused his discretion in finding sufficient merit in petitioners' claims to justify a grant of a preliminary injunction.

On March 5, 1971, the Second Circuit reversed Judge Lasker's order of preliminary injunction and remanded the case to the District Court. The Court of Appeals stated (Petition, pp. 4a-5a):

> "There can be no question but that the doctrine of collateral estoppel would be applied in any instance where the state court had determined a factual issue arising in a subsequent federal litigation. * * * But, to justify an injunction of a state court action, '[i]t is not sufficient to show that the matter properly before a state court embraces issues within the compass of the federal suit, even if the federal court has exclusive jurisdiction over its case'. * * * There is no reason why the state court cannot or should not determine issues of fact and state law relevant thereto as they come up in the state litigation. The subsequent effect of collateral estoppel, far from requiring the federal court to stay proceedings in the state court, is a result which

should be welcomed to avoid the task of reconsidering issues which have already been settled by another competent tribunal."

Benjamin promptly made a motion to shorten the time for issuance of the mandate of the Second Circuit. Vernitron and Amico opposed this motion on the ground that they would petition for certiorari within the normal 21-day stay of the mandate. On March 17, 1971, the Second Circuit granted Benjamin's motion and provided that the mandate should issue immediately. The District Court received the mandate on March 19, 1971, and immediately vacated its preliminary injunction. Immediately thereafter, Benjamin served notice upon petitioners of the settlement of an order in the state court on March 23, 1971 in accordance with the grant of partial summary judgment. On March 20, 1971, Vernitron and Amico filed this Petition, at the same time seeking a stay of the vacation of the preliminary injunction by motion to Justice Harlan. The stay was denied on March 22, 1971.

Vernitron and Amico then immediately moved in the state action for a "renewal or rehearing" of Benjamin's motion for summary judgment, claiming the discovery of new evidence increasing the size of their claims since the original state decision in July 1970. This motion was argued on March 31, 1971 before Justice Helman who temporarily refrained from signing Benjamin's proposed order. On April 6, 1971, Justice Helman denied the motion for rehearing and signed Benjamin's order granting him partial summary judgment in an amount of $1,008,598.27 plus interest and costs. On April 8, 1971, a judgment was entered in accordance with this order.

Reasons for Not Granting the Writ

I. The Decision Below on the "Aiding Jurisdiction" Exception to the Anti-Injunction Statute Is Clearly Correct.

Petitioners are attempting to parlay a 10-month-old federal litigation initiated solely to block entry of summary judgment for Benjamin in state court into a case raising "significant questions involving the enforcement and interpretation of the exclusive federal securities laws rights and remedies * * *" (Petition, p. 7). Indeed, if petitioners' completely unsupported view of the law prevailed, the results would no doubt be "significant" in the sense of having a catastrophic effect on federal-state relationships. A preemptive federal jurisdiction would be created in the fraud-in-securities-transactions field which would bar state court litigation of purely state claims, as long as facts might be tried in such state court litigation which would be relevant to a Securities Exchange Act claim. This would seem contrary to the Act itself, which provides at 15 U.S.C. §78bb:

> "(a) The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or at equity. * * *"

There is *no* case law support for the unique position petitioners advocate that state court fact-finding may be prevented by a federal injunction where the facts might have some relevance to an action under the Securities Exchange Act in federal court. Indeed, the only cases either squarely hold, or directly imply, the contrary. *Klein* v. *Walston,* 432 F.2d 936 (2d Cir. 1970); *Abramson* v. *Pennwood Invest-*

ment Corp., 392 F.2d 759, 762 (2d Cir. 1968); *Lyons* v. *Westinghouse*, 201 F.2d 510 (2d Cir. 1953), *cert. denied*, 345 U.S. 923 (1953); *Red Rock Cola Co.* v. *Red Rock Bottlers, Inc.*, 195 F.2d 406 (5th Cir. 1952); *Greater Continental Corp.* v. *Schechter*, 304 F. Supp. 325 (S.D.N.Y. 1969), *appeal dismissed*, 422 F.2d 1100 (2d Cir. 1970).

The last of these cases is remarkably similar to the instant case. Judge Marvin Frankel held that the anti-injunction statute barred preliminary injunctive relief against a state action. Schechter had sold his company to Continental receiving in return shares of Continental stock to be held in escrow for two years by Continental's attorneys (as here). Continental then supposedly discovered that Schechter had breached warranties and representations and did not pay Schechter a substantial part of the consideration. Schechter brought suit in the Supreme Court of the State of New York, New York County, seeking cash and the 100,000 Continental shares being held in escrow. At about the same time (here, Vernitron waited over seven months until a summary judgment motion was pending), Continental sued Schechter in federal court under the Securities Exchange Act of 1934, §10(b), claiming securities fraud in the breach of these representations.

Continental moved in the federal action for a preliminary injunction to stay further prosecution of the suit in the state court. Judge Frankel held that 28 U.S.C. §2283 barred a preliminary injunction issuing against prosecution of the action in New York Supreme Court. He held that it was "not sufficient to show that the matter properly before a state court embraces issues within the compass of the federal suit, even if the federal court has exclusive jurisdiction over its case" (*id.* at 330).

Although the quoted portion of Judge Frankel's opinion does not refer to the doctrine of collateral estoppel in so many words, it clearly rejects the theory that state trial of issues of fact with a consequent collateral estoppel effect can interfere with exclusive federal jurisdiction over a Securities Exchange Act claim. This is so because he found nothing wrong with a state trial of matter which "embraces issues within the compass of the federal suit" even though such a trial would necessarily involve a collateral estoppel effect in federal court.

The same result was reached by the Second Circuit by implication in *Klein* v. *Walston, supra.* There, the Second Circuit affirmed an order of the District Court staying proceedings under the Securities Exchange Act of 1934 in that court pending final determination of a prior state action based upon common law contract and fraud claims arising out of the same facts. The Second Circuit, 432 F.2d at 937, *supra,* stated:

> "While because of the exclusive jurisdiction of the federal courts to enforce the Securities Exchange Act of 1934, §27, the state court will not be able to determine certain claims asserted in the federal suit but not advanced in the state action, it can authoritatively determine the common law claims. * * *"

Yet a state determination of the common law claims would clearly involve state findings of fact having a collateral estoppel effect in the federal action. The Second Circuit was obviously aware that such a result would not interfere in any way with the District Court's exclusive jurisdiction over claims under the Securities Exchange Act of 1934.

And the District Court for the Southern District of New York has read the *Klein* decision in this manner. In *Essex Systems Company, Inc.* v. *Abramham Steinberg*, 70 Civ. 4595 (S.D.N.Y., Dec. 17, 1970) (opinion as yet unreported), Judge Croake refused to enjoin a state court proceeding in New Jersey in a situation almost identical to the situation in the case at bar. Judge Croake rested his decision in part on the *Klein* case, saying "[t]he *Klein* class mandates the conclusion that collateral estoppel of independent proof of part or even all the facts is not such a jurisdictional impairment as to allow an injunction 'in aid of jurisdiction' " (Opinion, p. 9).

II. There Is No Conflict of Decision on the "Aiding Jurisdiction" Exception.

And what do petitioners present in the face of this overwhelming, recent line of authority? They do not cite one single case from any jurisdiction anywhere in the United States (other than the opinion of the District Court below) which supports their novel position that the collateral estoppel effect of state court fact-finding can interfere with exclusive federal jurisdiction over a Securities Exchange Act claim so as to justify a federal injunction against the state court proceeding. Thus, not only is there no conflict of decision within the Second Circuit, but there is no conflict between the decisions of the various courts of appeals within the meaning of Rule 19(1)(b) of the Supreme Court Rules. Indeed, in the only case we have found on point from a circuit other than the Second Circuit, the Fifth Circuit has held in accord with the rule in the Second Circuit, *Red Rock Cola Co.* v. *Red Rock Bottlers, Inc., supra.*

Three of the cases relied upon by Vernitron and Amico at page 8 of the Petition do in fact come from circuits other than the Second Circuit, but these cases, as do the other cases cited by petitioners on page 8 of the Petition, simply hold that state court fact-finding does have a collateral estoppel or *res judicata* effect in a federal Securities Exchange Act litigation. There is no suggestion in any of these cases that the prior state court actions had improperly invaded the federal courts' jurisdiction or that the operation of these doctrines interfered in any way with the federal court's exclusive jurisdiction over claims under the Securities Exchange Act. There is no intimation that an injunction should have issued to block these respective state courts from trying these cases. There is no expression of helplessness at being in a position where the federal action must be dismissed because of the state adjudications.

In fact, in their entire Petition the only pretension Vernitron and Amico make of putting forth a ground for granting a Writ of Certiorari is in their statement that the decision of the Second Circuit is in conflict with this Court's recent decision in *Atlantic Coast Line Railroad Co.* v. *Brotherhood of Locomotive Engineers,* 398 U.S. 281 (1970). But in the cited case this Court *reversed* the award of an injunction against the state proceeding. In addition, the federal injunction sought was against enforcement of a state injunction *already in existence,* and consequently the problem of state court fact-finding having a collateral estoppel effect in federal court did not exist at all. Petitioners' only recourse is to attempt to derive support from the general language of this Court's opinion concerning the anti-injunction statute (Petition, p. 11). However, the language quoted, if anything, secures respondent in his posi-

tion. For this Court stated (*id.* at 295) that the "aiding jurisdiction" exception to the anti-injunction statute "implies something similar to the concept of injunctions to 'protect or effectuate' judgments." Federal injunctive relief must be necessary "to prevent a state court from so interfering with a federal court's consideration or disposition of a case as to seriously impair the federal court's flexibility and authority to decide that case."

It is clear what is meant by this language. The state court must be actually attempting in some way to interfere with the federal court's *jurisdiction.* Thus, the classic case occurs when a state court attempts to assume jurisdiction over a *res,* over which a federal court has acquired prior jurisdiction. To allow the state court to assume jurisdiction over the same *res* would be to remove the federal court's entire basis for proceeding in the action. *Hyde Construction Co.* v. *Koehring Co.,* 388 F. 2d 501 (10th Cir. 1968), *cert. denied,* 391 U.S. 905 (1968); *Doyne* v. *Saettele,* 112 F. 2d 155 (8th Cir. 1940). As the Second Circuit noted below, decision of facts by a state court does not interfere with federal *jurisdiction* but "is a result which should be welcomed to avoid the task of reconsidering issues which have already been settled by another competent tribunal" (Petition, p. 5a).

III. The Decision Below on the "Act of Congress" Exception to the Anti-Injunction Statute Is Clearly Correct.

As a second prong in their Petition for a Writ of Certiorari, Vernitron and Amico argue that the injunction in the District Court came within the "Act of Congress" exception to the anti-injunction statute (Petition, pp. 12, 20a).

Petitioners place their sole reliance on *Studebaker Corporation* v. *Gittlin*, 360 F.2d 692 (2d Cir. 1966). Yet in that case, the injunction was sought against state proceedings which would *themselves* have violated the Proxy Rules issued by the SEC under §14(a) of Securities Exchange Act. In state court, Gittlin sought the use of other stockholders' authorizations to obtain inspection of Studebaker's shareholders' list. Studebaker claimed Gittlin had obtained these authorizations without filing the proxy material required by the Proxy Rules under §14(a).

The Second Circuit held that the policy of the anti-injunction statute was "superseded by the need for an immediate and effective enforcement of federal securities regulations and statutes" (*id.* at 698), and this brought a private party within the "Act of Congress" exception.* However, the need for immediate and effective enforcement was occasioned by Gittlin's attempted use of the illegal authorizations in state court. If Gittlin had been allowed to use the allegedly invalid stockholders' authorizations in the New York court proceedings to obtain an inspection of the Studebaker shareholders' list, a later finding in federal court that these authorizations had been obtained in violation of the Proxy Rules issued by the SEC would have been without any force since the damage would have been complete. The shareholders' list would have been obtained and inspected. The federal plaintiffs in that case, therefore, were acting as private parties to *enforce* the federal securities laws. Benjamin was making no attempt in his

* §21(e) of the Securities Exchange Act of 1934 expressly permits the SEC to bring an action to enjoin violations of the Act, and the Second Circuit held a private party also authorized to seek an injunction under the principles of *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964).

state court action to violate the federal securities laws. His claim is simply one for breach of contract. The issue of immediate and effective enforcement of the federal securities laws is not involved at all. Both Judge Lasker (Petition, p. 11a) and the Second Circuit (Petition, p. 5a) agreed with this interpretation of the *Studebaker* case.

However, even if the opinion below of the Second Circuit can be read to have "improperly circumscribed the holding" in the *Studebaker* case, then petitioners are still not entitled to a Writ. For *both* the opinion below and the *Studebaker* case involved decisions of the Second Circuit, and, if anything, the opinion below, as the later decision, is controlling and there is no conflict. In such a case, issuance of a Writ of Certiorari is not appropriate since the Second Circuit may reconcile its own internal difficulties by development of its case law. See *Wisniewski* v. *United States,* 353 U.S. 901 (1957).

IV. The Petition Is Moot.

Finally, and perhaps most important of all, a Writ of Certiorari should not be granted because the question of the propriety of a preliminary injunction against the state action has been mooted by the vacation of the preliminary injunction and the entry of judgment in the state court. Petitioners' only fear has been that the entry of a judgment would result in a collateral estoppel or *res judicata* effect in their federal proceeding. If they are right, then the damage has irretrievably occurred because judgment has been entered. See *Brownlow* v. *Schwartz,* 261 U.S. 216 (1923). Whether any further "damage" can occur to petitioners by reason of *another* judgment resulting from

the trial of their counterclaims in the state action is entirely up to petitioners, since they are free to choose not to prosecute their counterclaims in the state action (by voluntary dismissal or inaction) and to proceed instead in federal court, as they have consistently claimed they desire to do.

Conclusion

For the reasons set forth above, petitioners should be denied a Writ of Certiorari to review the judgment and opinion of the Second Circuit.

Respectfully submitted,

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April 19, 1971

APPENDIX

Statute

15 U.S.C. §78bb:

"(a) The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this chapter shall recover through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of. Nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder."

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IN THE

Supreme Court of the United States

October Term 1970

No. 1493

VERNITRON CORPORATION and AMERICAN MEDICAL INSTRUMENT CORPORATION,

Petitioners,

against

PAUL BENJAMIN,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF

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REPLY BRIEF

Argument

Petitioners Vernitron Corporation ("Vernitron") and American Medical Instrument Corporation ("Amico") submit this brief in reply to the arguments asserted by Respondent Paul Benjamin ("Benjamin") that (i) the propriety of the preliminary injunction has been mooted by the vacation of the injunction and entry of judgment in the state court; and (ii) the reinstatement of the injunction would in some undefined way have a "catastrophic effect on federal-state relationships."

I.

The Petition is not Moot.

Respondent's argument that the petition has been mooted by the state court's entry of summary judgment is the culmination of respondent's most unfair attempt to capitalize on his own questionable conduct in obtaining the vacation of the injunction by the Hon. Morris E. Lasker in the District Court without notice to the petitioners and without disclosure to the District Court of the petitioners' announced intention promptly to seek review of the Second Circuit's decision by this Court. Indeed, respondent's questionable procedure led the State Court, which entered judgment, to find erroneously that this Court in fact had denied certiorari. A copy of the written decision of Justice Nathaniel T. Helman of the New York State Court, dated April 6, 1971, rejecting Vernitron's motion for rehearing and renewal of Benjamin's motion for partial summary judgment is annexed hereto.

Justice Helman's refusal to reconsider—even in the face of substantial allegations and evidence of fraud, misrepresentations, and nondisclosures of material facts—Vernitron's assertion that partial summary judgment should not be granted to respondent without a trial of the issues is not an event which has permanently altered Vernitron's substantive rights in either the state or federal action. There has been no ouster of federal jurisdiction resulting from the entry of the state court judgment. All there has been thus far is some substantiation for petitioners' fears that the federal action may at some future date be dismissed on respondent's motion if and when he can show to the satisfaction of the District Court that petitioners' federal action is barred by the doctrine of collateral estoppel or *res judicata*. Such a determination has not yet been made or even entertained.

Hence, contrary to the decision of *Brownslow* v. *Schwartz*, 261 U.S. 216 (1923), cited by Benjamin, the in-

stant petition is not mooted by reason of events occurring subsequent to the decision of the Circuit Court. In *Brownslow* this Court determined that the completion of a building operated to destroy the relief sought in the litigation and the writ was accordingly mooted. Nothing so drastic has occurred here, however, in either the state or federal action which could operate to render ineffectual any judgment of this Court.

What has occurred is the following:

On April 8, 1971, a judgment was entered against Vernitron for in excess of $1 million, but the execution of that judgment has been stayed temporarily. Assuming it is determined by this Court that the Second Circuit's reversal of Judge Lasker's decision was improper, this Court could order the Second Circuit to reinstate the injunction and thereby stay execution of the state judgment pending the disposition of the federal proceeding. Furthermore, it is also within the power of this Court or the Second Circuit to order Banjamin to vacate his judgment in the state court action. This, obviously, would be the most appropriate remedy to fashion under these unusual circumstances as it would remove the possibility of petitioners' being precluded from litigating their exclusively federal securities law claims in the federal court.

Vernitron intends to appeal promptly to the Appellate Division of the Supreme Court of the State of New York, First Department, and, if necessary, to the New York Court of Appeals, to seek review of Justice Helman's novel decision that misrepresentations as to the earnings of an on-going business are irrelevant to a purchaser's action for damages and/or rescission. Assuming that Vernitron is successful in its state appeal, there would be no possibility of any *res judicata* or collateral estoppel effects which would inhibit the prosecution of the federal action.

In short, the entry of the state court judgment against Vernitron has done no more than to permit Benjamin to move one step closer to closing the door on petitioners' right to *one trial* of its Securities Act claims. The entry of the state court judgment cannot render this appeal moot until the federal doors are finally closed to Vernitron and Amico.

II.

The Reinstatement of the Injunction will not Adversely Affect Federal-State Relations.

In his effort to avoid at all costs *one trial* of the issues between the parties, Benjamin has resorted to the argument that any action by the federal courts to assert their exclusive jurisdiction to determine claims arising under the federal securities laws and to fashion an appropriate remedy under those laws would in some undefined way have a "catastrophic effect on federal-state relations." Such an argument is without basis, and overlooks entirely the particular facts of the instant case, which the District Court properly grasped.

The simple facts are that Benjamin expressly represented and warranted in the Agreement and with the customary and usual form required in a securities transaction, the Balance Sheet, *and the earnings statements of Amico.* Asserting that there had been substantial misrepresentations as to the earnings statements, and that the acquisition had been made, as respondent well knew, upon a multiple-of-earnings formula which is standard and accepted in the investment community, Vernitron refused to register for public sale and distribution the shares of Vernitron common stock acquired by Benjamin through his alleged securities fraud. The only "breach" charged to Vernitron is its refusal to act as a conduit in Benjamin's scheme to defraud the public.

In the State Court action which Benjamin commenced, he moved for partial summary judgment. New York Civil Practice Law and Rules § 3212(e) provides that a motion for partial summary judgment "shall be denied if any party shall show facts sufficient to require a trial of any issue of fact other than an issue as to the amount or extent of damages." Accordingly, the State Court undertook to analyze Vernitron's counterclaims, including the counterclaim for rescission rooted in Section 29(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78cc(b). Justice Helman refused as a matter of *state law* to recognize Vernitron's claims as to Benjamin's misrepresentations with respect to Amico's earnings; and he thereupon determined *upon the pleadings* that the Balance Sheet discrepancies of some $43,000, were, on a dollar-for-dollar basis, the maximum recovery available to Vernitron for Benjamin's misrepresentations. Incredible as it seems, such a holding was rendered despite the fact that the entire Balance Sheet value (net worth) of Amico, at the time Vernitron agreed to acquire the business for $1,500,000, was only $300,000.

The State Court was induced by respondent to reach this clearly erroneous result because Justice Helman was convinced that "Defendant [Vernitron] has selected the Federal Court as his forum for the determination of the S.E.C. questions involved, and will not be prejudiced in that regard *by the present determination.*" In fact, as all four federal judges who have heard argument with respect to this case have indicated, the "Balance Sheet" test applied by Judge Helman may well become, if permitted to stand, the law of the case, and Vernitron will be estopped collaterally from proving the misrepresentations and nondisclosures relating to Amico's earnings. The "Balance Sheet" test may also become a precedent and battle cry for securities act violators who are anxious to avoid the force and effect of the provisions of the securities acts and the scrutiny of the federal courts.

Virtually every securities seller or purchaser who can establish a touchstone of jurisdiction in the State of New York, home of the two principal stock exchanges, will be able to invoke the provisions of the partial summary judgment procedure whenever the other party has refused, on the grounds of alleged securities act violations, to fully perform contracts involving the purchase or sale of securities.

In short, it is not the State Court's fact-finding process which would be challenged by the grant of injunctive relief, but, rather, its refusal to permit Vernitron to invoke the time-honored fact-finding processes with respect to its claims that the earnings misrepresentations made by Benjamin unlawfully induced Vernitron to enter into the Agreement. Succinctly framed, approbation of injunctive relief in the instant case need only instruct state forums that the mere existence of a state created procedure, such as the partial summary judgment procedure, does not and cannot be used to permit a state court to determine summarily claims arising under the securities acts for which exclusive jurisdiction has been vested in the federal courts. *cf. Wellington Computor Graphics, Inc.* v. *Modell*, 315 F. Supp. 24 (S.D.N.Y. 1970). It was only because the spectre of such an application of the New York partial summary judgment procedure was at hand, that Vernitron sought to stay the proceedings pending before the state court.

CONCLUSION

For the reasons set forth above, a writ of certiorari should issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit.

Respectfully submitted,

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Decision of Helman, *J.* of April 6, 1971

SUPREME COURT

NEW YORK COUNTY

SPECIAL TERM—PART I

Index No. 8753—1970

———o———

PAUL BENJAMIN,

Plaintiff,

against

VERNITRON CORPORATION, AMERICAN MEDICAL INSTRUMENT CORPORATION, and MARSHALL, BRATTER, GREENE, ALLISON & TUCKER, in its capacity as Escrow Agent,

Defendants.

———o———

HELMAN, J.:

Under the terms of a contract of sale, dated December 20, 1967, plaintiff agreed to sell to defendant all of its "assets, properties, business and good will" for the sum of $1,500,000. Payment was to be made in stock of the Vernitron Corp., with leave to the seller to periodically require registration of various amounts of stock so that shares might be sold on his behalf. Charging a breach of this obligation to register with the SEC, plaintiff brought this action and was granted summary judgment in the amount of approximately $1,000,000, leaving open for trial a claim of approximately $40,000.

Attempts by defendant to stay the determination of the summary judgment motion by proceedings in the Federal Court were initially unsuccessful. The Federal Court action, instituted some six months after the filing of the

answer in this action, was predicated upon an alleged violation of the SEC Act of 1934, and was based upon broad allegations of fraud and concealment by this plaintiff. Following the granting of summary judgment to plaintiff in this court, defendant obtained in the Federal Court a preliminary injunction against any further prosecution of this action. On appeal to the Circuit Court of Appeals, the preliminary injunction was thereafter vacated, and a subsequent petition to the United States Supreme Court for a writ of certiorari brought by defendant denied, thus freeing the pending proceeding from further restraints.

Defendant now moves for a rehearing and renewal of plaintiff's motion for summary judgment, pursuant to rule 2221 of the CPLR, upon affidavits alleging the discovery of new evidence not previously available to defendant, supportive of defendant's counterclaim for rescission. Explanations are offered by defendant for its delay of three years in uncovering some of the alleged misrepresentations and concealments of the plaintiff, but they lack persuasiveness and even logic. Defendant, in its Federal Court actions, had ample opportunity by depositions to obtain complete disclosure of the subject matter of these charges, and even the most cursory examinations of records of plaintiff's dealings with the U. S. Contracting Division would have provided defendant with all of the information it sought. Additional allegations of fraudulent concealment relating to the chrome-plating of scissors are unimpressive, for defendant has had possession of those items for three years and with the slightest effort could have obtained all of the information relating thereto at or before making its purchase. The whole area of "non-disclosure" on which defendant relies, belies the express language of the firm written contract of the parties, and involves nothing more than a dissatisfied buyer who three years later regrets his purchase.

Nevertheless, because of the substantial amounts involved, the court has examined in detail the claims of de-

fendant with a view to determining whether real issues are here presented, and whether a trial of the factual questions raised by defendant is required in the interests of justice. Essentially, what is presently alleged has been the subject of prior consideration by the court. Defendant asserts that it relied strongly on plaintiff's representations as to earnings and income, and that it based its original offer on a "multiple of earnings" formula. The contract of sale, however, prepared by skilled attorneys, dealt with a sale of "assets, properties and good will" and contained no representations as to earnings which might be used as a basis for a multiplication formula. Instead, the language of article V, subdivision 111, refers to earnings as disclosed by the books and records, and in customary language, states that they are "true and correct and present fairly its financial condition and the results of its operations." At best, defendant's use of a "multiple of earnings" theory was its own choice of a method of appraisal and plaintiff is certainly not bound thereby. That buyer chose to use 10 times earnings as a method of evaluation, did not mean that a seller could not fix his price in his own way, particularly, where, as here, no representations were made.

The fact that occasional differences arose between the U. S. Defense Supply Agency and the plaintiff, prior to the sale, concerning quality and performance does not provide defendant with claim of "concealment" available in support of its "rescission" counterclaim. These were insubstantial matters, and as appears from the Agency's letter of February 19, 1971, in no way affected the business relationship between the parties; in fact, the company, under defendant's control, presently engages in business with the Agency. It is to be noted that no claim has ever been asserted by the United States Government arising out of these contracts, and three years having passed, it is difficult to understand how defendant could have sustained any damage from this alleged concealment. If defendant

has suffered a reduction in awards of government contracts during the three years of its operation, it offers no evidence that such reductions were occasioned by the derelictions of the plaintiff previous to the transfer of its business. Indeed, the affidavits of defendant are replete with generalizations and liberal uses of the word "fraud", but the same affidavits lack factual matter from which the court can draw an inference of substantial damage resulting from any misrepresentation by plaintiff. In essence, plaintiff warranted nothing more than the computations reported on its balance sheets as prepared by the accountant for the selling corporation, and a falling off of business following the sale may not properly be attributed to the plaintiff. A further attempt to make use of a broker's memorandum, unsigned, and recently discovered, is likewise of little significance in demonstrating that issues exist requiring trial. Defendant has selected the Federal Court as his forum for the determination of the S.E.C. questions involved, and will not be prejudiced in that regard by the present determination.

On the whole, defendant has failed to demonstrate a sound basis for a reconsideration of the prior holding of the court, and its application will in all respects be denied.

Dated, April 6th, 1971

Order Signed

/s/ N T H
J. S. C.

(Filed April 6, 1971
New York Co. Clerk's Office)